

**testimony of mike mcTighe, Chief executive officer,
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**before the commerce Committee of the United states senate
hearing on Telecommunications mergers
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Mr. Chairman, thank you for this opportunity to provide the perspective of Cable and Wireless on mergers in the telecommunications industry. I joined Cable & Wireless in the spring of 1999 as Chief Executive Officer of Cable & Wireless Global Operations. Cable & Wireless is an international leader in integrated communications, operating in 70 countries worldwide. With its global reach and ownership of one of the largest and fastest Internet networks worldwide, Cable & Wireless is a premier provider of domestic and international data and Internet solutions to business customers. Cable & Wireless headquarters its North American operations in the Tyson's Corner high-tech corridor in Virginia.

I have nearly 20 years of experience in the high technology industry. My career in international telecommunications has encompassed senior positions in Europe and the USA, and has included roles in sales, marketing and operations for General Electric, Motorola, Phillips Electronics and Siemens AG.

Cable & Wireless is here this morning to discuss several public policy issues surrounding mergers in the telecommunications industry. The company offers a unique perspective on this topic, as we are a recent purchaser of assets required to be divested in a merger that, at its inception, was the largest telecommunications merger of all time involving approximately \$40 billion. The divestiture of the MCI Internet backbone assets acquired by Cable & Wireless was the largest divestiture of an integrated business in U.S merger history. This experience provides Cable & Wireless with highly relevant expertise in three areas: competition issues; the need for enforcement of conditions placed on mergers; and the efficacy of divestitures of integrated businesses.

I'd like to start my testimony with a story to illustrate our concerns in these areas before speaking more in depth of its relevance to your policy-making goals.

In July 1998, as a condition of their proposed merger, MCI and WorldCom made commitments to the European Commission and the U.S. Department of Justice to divest MCI's Internet backbone business. Internet backbones are the largest national or global networks that carry Internet traffic between smaller networks and consumers.

In its investigation of the merger of MCI and WorldCom, the European Commission had found that MCI and WorldCom competed in a global market for top level networks – those that can reach anywhere on the Internet through their own peering arrangements, without having to pay anyone for transit. The Commission noted that WorldCom's Internet subsidiary, UUNet, already had “very substantial size by comparison with its competitors” and was, by itself, “close to achieving dominance.” Thus, “[t]he combination of the Internet backbone networks of WorldCom and MCI would create a network of such absolute and relative size that the combined entity could behave to an appreciable extent independently of its competitors and customers.” Such an entity could disadvantage its competitors by “oblig[ing] them to pay for access to its network” or “leverage its position to gain a dominant position downstream.” Furthermore, “[b]ecause of the specific features of network competition and the existence of network externalities which make it valuable for customers to have access to the largest network, MCI WorldCom's position can hardly be challenged once it has obtained a dominant position.”

Based on these findings, the Commission concluded that the merger of MCI and WorldCom, if unaltered, “would lead to the creation of a dominant position in the market for the provision of top level or universal Internet connectivity.” In order to overcome these competition concerns, MCI and WorldCom entered into “Undertakings” that required MCI to divest its Internet business “as an operating entity.” The Commission approved the merger of MCI and WorldCom “subject to the condition of **full compliance** with the

Undertakings. . . .”

The U.S. Department of Justice specifically relied on the commitments reflected in the Undertakings when it cleared the merger a week later. The Justice Department had assisted the European Commission “in evaluating and implementing the divestiture proposal, which had been submitted to both the Commission and the Department of Justice.” In announcing the merger clearance, Assistant Attorney General Joel Klein highlighted the benefits of the divestiture:

This divestiture benefits anyone who relies on the Internet because it preserves competition among major Internet service providers. Consumers will benefit with lower prices, higher quality, and greater innovation in this dynamic and emerging industry.

Thus, in order to obtain approval of their merger, MCI and WorldCom agreed to detailed conditions embodied in the Undertakings. These conditions required MCI WorldCom, among other things:

to transfer “all necessary employees to support the iMCI Business being transferred”;

to transfer “all MCI’s contracts with wholesale and retail customers for the provision of Internet access”;

to “make available all other necessary support arrangements to fulfill existing contractual obligations of the iMCI Business – and to accommodate growth of that business”;

to provide support services “at favourable rates”; and

to refrain from soliciting or contracting to provide dedicated Internet access services to the former MCI Internet customers for specified periods.

One year after the divestiture, we are sorry to report that MCI WorldCom has not honored its commitments to the European Commission and the Justice Department. MCI WorldCom's material violations of the Undertakings include:

Failure to transfer all personnel necessary for the operation of the former MCI Internet business at prior performance and service level standards.

For example, MCI transferred only 43 sales and sales support representatives to support more than 3,300 business customers.

Failure to provide contract documentation and other key customer information to Cable & Wireless at closing. For example, MCI WorldCom withheld 2,000 written customer contracts – half of the contracts provided to date – until at least seven months after closing.

Failure to provide necessary services, systems and support, such as competent customer billing services.

Failure to provide services at favorable rates.

Failure to conduct business in the ordinary course, including the reasonable retention and solicitation of customers, prior to closing.

Solicitation of transferred customers, in violation of the non-compete provisions of the Undertakings.

MCI WorldCom's material breaches of the Undertakings threaten to impair Cable & Wireless's competitiveness. The lack of essential personnel, information and services have compromised Cable & Wireless's ability to retain and expand business with existing customers or to secure new customers. Thus, despite the 50 to 100 percent growth rates experienced by MCI prior to the divestiture, and the continued rapid growth of the industry as a whole, Cable & Wireless's Internet revenues have not kept pace. Unless this trend is

reversed, Cable & Wireless will, by definition, lose market share and will eventually be unable to provide effective competition in the market. Cable & Wireless has spent a year recruiting and training employees and has announced a nearly \$700 million investment into the network to make up for the setbacks caused by MCI WorldCom's refusal to honor their commitments.

We believe that Cable & Wireless's experience as the purchaser of the MCI Internet business should weigh heavily in any antitrust review of the MCI WorldCom/Sprint acquisition, and should be instructive for other telecommunications mergers.

COMPETITION ISSUES

If our collective goal is competition in the marketplace, we must adequately assess the threat to competition.

MCI WorldCom now proposes to acquire Sprint, another major competitor in the market for top level Internet connectivity. MCI WorldCom's UUNet division is the largest Internet backbone, estimated to carry 50% of the world's traffic. The European Commission found last year that UUNet was nearly dominant by itself, and it has only grown in marketshare since. The European Commission also identified Sprint among the "big four" backbone providers, along with WorldCom, MCI (now Cable & Wireless) and GTE. Sprint's share of traffic in 1998 was estimated at 18 percent, second only to UUNet. UUNet continues to grow at dramatic rates; its executives have been repeatedly quoted as stating that demand for capacity is growing at 1,000 percent per year.

Further, the Internet backbone market is highly susceptible to domination by a large network. Because the nature of network competition makes it advantageous for customers to have access to the largest network, having a large network is a high barrier to entry by competitors. As the European Commission concluded last year, a dominant network could impose costs on or reduce the quality of service to competing backbone networks. A dominant backbone provider could leverage its position to gain a dominant position in

downstream market – for example, retail Internet Service Providers.

MCI WorldCom's acquisition of Sprint would constitute the same serious threat to competition in the Internet backbone as MCI's merger with WorldCom just one year ago. Further, a commitment to divest UUNet or Sprint's Internet assets may not adequately protect competition and consumers if our experience with MCIWorldCom and its agreement to divest MCI's Internet backbone to Cable & Wireless is any indication. Absent clear indications that MCI WorldCom would honor such commitments and that the regulators would enforce the agreement, Congress should be concerned about what a combined MCIWorldCom-Sprint would mean for competition and the flow of Internet traffic.

ENFORCEMENT ISSUES

Efforts by the European Commission and Justice Department to ensure competition in telecommunications markets will not be effective if left unenforced. However, little has been done to ensure the "Undertakings" imposed by these agencies are adhered to. If the European Commission and Justice Department do not enforce MCIWorldCom's Commitment to divest the MCI Internet business fully, it may conclude that it can breach any commitment made to U.S. or European officials to divest the UUNet or Sprint Internet business without adverse consequences. Lack of enforcement may also compromise the effectiveness of divestiture as a remedy for other mergers in the telecommunications industry and elsewhere.

Failure to enforce MCI WorldCom's commitment to fully divest the MCI Internet business raises additional questions as to the effectiveness of cooperation with the European Commission. The European Commission took the lead in investigating the merger of MCI and WorldCom, entering into the "Undertakings," which laid out the commitment to divest. The Justice Department cleared the merger one week after the European Commission, expressly relying on those divestiture commitments. The Justice Department should not defer to the European Commission and rely on merging parties'

commitments to the European Commission absent assurances that the European Commission will demand full compliance with those commitments and/or the Justice Department can and will enforce such commitments independently, if necessary to protect the interests of U.S. consumers.

EFFICACY OF DIVESTITURE OF INTEGRATED BUSINESSES

Another question is whether divestiture in a market containing highly integrated services is doomed to failure. Cable & Wireless believes these divestitures **can** work, but the complexity of the situation should not be taken lightly. At a minimum, they call for a level of involvement and enforcement by regulators that other mergers may not require.

Divestiture of a fully integrated business is much more complicated than simply selling off a separate operating division or wholly-owned subsidiary. MCI's Internet business was highly integrated with its other telecommunications services. The MCI Internet assets were not organized into a separate, free standing division, as is the case with UUNet, for example. Personnel have knowledge about and responsibility for both Internet and non-Internet businesses. The same engineers, sales force, billing mechanism and databases all serve the same customers for a variety of products such as long-distance, wireless, pre-paid calling cards, messaging services and Internet backbone products. Any costs or disruptions resulting from the transfer of these multiple purpose assets must be borne by the seller, which, after all, receives the benefit of merger clearance. Moreover, the seller will likely need to provide additional services to purchaser while it makes a transition to its own systems.

However, this allows the divesting party to hold some very important keys to interfacing with customers. In fact, it gives the divesting party an incentive to degrade service while providing it in the name of another company. Any problems are likely to cause former customers to migrate back to the original service provider.

The European Commission, recognizing this complexity, first suggested that

WorldCom should divest the more separate UUNet asset as a way to alleviate some of these concerns. The parties refused and offered MCI's highly integrated Internet business instead. Cable & Wireless's experience demonstrates that it is difficult to adequately divest such integrated businesses. With the knowledge gained from that experience, we suggest that, in the context of the MCIWorldCom/Sprint merger, it is more appropriate to require the divestiture of UUNET rather than again try to effectively quantify the assets of Sprint's integrated Internet backbone business.

CONCLUSION

Policy makers must inquire, if the right choices for divestiture are not made, the conditions are not fully enforced, and companies refuse to live up to their commitments, can we hope to maintain competitive markets?

The Internet is a revolutionary technology that offers enormous benefits to consumers in the next century. It has given rise to countless new information, education and entertainment products while reducing the cost of communication on a global basis. Electronic commerce on the Internet has the potential to lower transaction costs, to give consumers access to better information about available products and services, and to provide producers with more information about the markets they serve. By facilitating the exchange of technical, cultural and commercial knowledge, the Internet encourages product innovation and efficiency in product design, manufacture and distribution. Competition among the backbone networks at the heart of the Internet must be preserved to ensure that the full potential of this critically important technology is realized.

Companies with dominance in the market should not be able to simply hobble their primary competition by agreeing to conditions they never intend to fulfill or by maintaining control over critical elements of service delivery due to integration which allow them to degrade service while acting in a competitor's name. This thwarts the goal of competition. Policy makers must not allow such bad actors to succeed with this strategy in the marketplace.

Cable & Wireless remains committed to being a major competitive force in the Internet market. We have made substantial investments to expand our network and improve our service to customers. In addition, we have pursued every available option to compel or persuade MCI WorldCom to meet its obligations and, thereby, to ensure Cable & Wireless's future competitiveness.

The recent experience of Cable & Wireless, in perhaps the most critical of the marketplaces you are examining today, brings to the fore issues of serious import to your review of merger policy. Congress and regulators must ensure competition. The tools they use to accomplish that goal must include adequate enforcement mechanisms. They also must fully address the complexities of integrated markets. If more scrutiny can not be given, U.S. consumers must be protected by the refusal to allow such mergers.

Again, thank you for this opportunity to provide Cable & Wireless's perspective on telecommunications mergers. I would be happy to address any questions from members of the Committee.